UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

JUNO KURIAKOSE, Individually and On Behalf of All Others Similarly Situated, Plaintiff, v. FEDERAL HOME LOAN MORTGAGE COMPANY, RICHARD SYRON, PATRICIA L. COOK, and ANTHONY S. PISZEL, Defendants.	No. 08-cv-7281 (JFK)

INDIVIDUAL DEFENDANTS' REPLY MEMORANDUM
IN FURTHER SUPPORT OF THEIR MOTION
TO DISMISS THE AMENDED COMPLAINT WITH PREJUDICE

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STATUTE

15 U.S.C. § 78u-4(b)(2) 4

Defendants Richard Syron, Patricia L. Cook, and Anthony S. Piszel (the "Individual Defendants") respectfully submit this Reply Memorandum in Further Support of Their Motion To Dismiss the Amended Complaint With Prejudice.

INTRODUCTION

The Plaintiffs' Opposition fails to address the principal dispositive defects in the claims asserted against each Individual Defendant. As a preliminary matter, the purported misstatements upon which the claims against the Individual Defendants are based are not actionable. In their Opening Brief and the three charts attached thereto, the Individual Defendants detailed on a statement-by-statement basis why each alleged misstatement is not actionable. The Plaintiffs' Opposition does not respond. Nor, as the Individual Defendants have argued, does the Complaint provide any viable theory of loss causation. The Individual Defendants will not argue these points further in this Reply, and are content to rest on the arguments advanced in their Opening Brief, as well as those advanced in the Opening and Reply Briefs of Defendant Federal Home Loan Mortgage Corporation ("Freddie Mac" or the "Company").[1]

This Reply will address the Opposition's failure to demonstrate scienter. As argued in the Individual Defendants' Opening Brief and further explained below, there is no viable theory that any Individual Defendant had any motive to commit fraud. And notwithstanding the requirement that Plaintiffs do so, the Opposition does not even attempt—nor could it—to explain, on a defendant-by-defendant basis, and on a statement-by-statement basis, how the Complaint establishes that *each* Individual Defendant had actual knowledge of or reckless disregard for *particularized facts that contradicted specific statements* made by each of them.

[1] The Individual Defendants incorporate by reference the Company's Opening and Reply briefs.

These failings are dispositive of the fraud claims asserted individually against Mr. Syron, Mr. Piszel, and Ms. Cook.

ARGUMENT

I. NO INDIVIDUAL DEFENDANT HAD ANY MOTIVE TO COMMIT FRAUD

The Opposition has no viable response to the fact that the three Individual Defendants had no motive to commit fraud. As a preliminary matter, none of the Individual Defendants sold a single share of Freddie Mac stock during the purported Class Period. Absent such sales, the Individual Defendants simply had no motive to fraudulently inflate the Company's stock price.

As to Plaintiffs' conclusory contention that the Individual Defendants' compensation (as opposed to stock sales) somehow motivated them to commit fraud, *see* Plaintiffs' Omnibus Opposition to Defendants' Motions to Dismiss ("Opp'n") at 45-47 & n.22, the Opposition does not identify any term of their compensation agreements that supplied some perverse incentive to lie about Freddie Mac's "capital adequacy," its "subprime" investments, or any other aspect of Freddie Mac's financial condition. *See* Opp'n at 45-47; Compl. ¶¶ 126-33. Also missing is any attempt to reconcile the contention that the Individual Defendants would be rewarded for *increased* subprime investments, *see* Compl. ¶ 133, with the flatly contradictory contention that the Individual Defendants somehow also had a motive to *diminish and downplay* Freddie Mac's participation in those very same investments. *See* Individual Defendants' Memorandum of Law in Support of Their Motion To Dismiss ("I.D. Opening Br.") at 14.

Absent an actionable improper benefit in the form of insider stock sales or perverse compensation rewards, the Opposition resorts to what is in effect a plea for an exemption from settled doctrine. It is well-established that an executive's desire to enhance a company's profitability or to maintain his job does not give rise to a "strong inference" of scienter as a matter of law because those motivations are ordinarily and properly held by every executive. *See*

I.D. Opening Br. at 13-14. Yet Plaintiffs claim that, "[w]hile general motive allegations attributable to ***any*** corporation are ordinarily insufficient, this Court should consider Plaintiffs' motive allegations within the context of the unique role that Freddie served in the residential mortgage marketplace." (citation omitted) (emphasis in original). Opp'n at 45-46. As Plaintiffs frame this argument premised on Freddie Mac's so-called "unique role," the Company was in a "bidding war for market-share with Fannie," leading to "pressure to remain relevant," and "caus[ing] Freddie to substantially increase its purchases of non-prime and non-traditional loans." Opp'n at 46 (internal citations and quotation marks omitted). This supposed drive for market share was combined with "the dual motives of enhancing short-term profitability and staving off government interference." This in turn supposedly provided the Defendants with "little, if any, incentive to accurately report the Company's capital position." *Id*.

The Opposition's "pejorative characterization of … ordinary corporate desires" does not rescue the Plaintiffs' motive argument in the face of contrary law. *In re Bristol-Myers Squibb Sec. Litig.*, 312 F. Supp. 2d 549, 560 (S.D.N.Y. 2004). Stripped of rhetoric, Plaintiffs' theory reduces to several unremarkable propositions, none of which is sufficient to raise a "strong inference" of scienter. First, the Company, as part of its supposed "market share" battle with Fannie Mae, wished to improve its performance relative to its perceived peer firms—something any executive would desire. *See, e.g., In re Medtronic Inc. Sec. Litig.*, 618 F. Supp. 2d 1016, 1036-37 (D. Minn. 2009) (alleged desire to maintain market share not sufficient to raise strong inference of scienter). Second, the Individual Defendants—like all executives—were motivated to increase the Company's profitability, and thus its stock price. *See Acito v. IMCERA Group, Inc.*, 47 F.3d 47, 54 (2d Cir. 1995) (holding that desire to maintain high stock price not sufficient "personal benefit" to meet motive requirement). Third, the Individual Defendants' alleged wish to "stave off government interference" reflected a desire to keep Freddie Mac independent and their jobs secure—again, a motive shared by all executives. *See In re PXRE Group Ltd. Sec. Litig.*, 600 F. Supp. 2d 510, 531-32 (S.D.N.Y. 2009) (desire to raise capital to prevent "negative ramifications" [e.g., Conservatorship] too general to suggest scienter); *In re Rhodia S.A. Sec. Litig.*, 531 F. Supp. 2d 527, 549-50 (S.D.N.Y. 2007) (dismissing claims predicated on motive to avoid ouster). In sum, any "unique role" Freddie Mac may play does not establish a motive on the part of Mr. Syron, Mr. Piszel, or Ms. Cook to defraud their fellow shareholders.

II. PLAINTIFFS HAVE NOT ESTABLISHED THAT ANY INDIVIDUAL DEFENDANT MADE ANY STATEMENT KNOWING IT TO BE FALSE

Where, as here, Plaintiffs have failed to demonstrate any cognizable motive to defraud, they bear a "correspondingly greater" burden to show that each Individual Defendant was aware of or recklessly disregarded facts that specifically contradicted his or her alleged misstatements. *Kalnit v. Eichler*, 264 F.3d 131, 142 (2d Cir. 2001); *cf. Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 313-14 (2007) (quoting 15 U.S.C. § 78u-4(b)(2)). The Opposition devotes barely any text to this requirement. *See* Opp'n at 48-49. The Plaintiffs still have not provided a defendant-by-defendant and statement-by-statement showing as to how each Individual Defendant somehow had direct, actual knowledge of particularized facts that contradicted a specific statement.[2] The Plaintiffs' failure in this regard is not a mere technicality. It exposes the fatal defect in the claims against each of the Individual Defendants considered independently.

[2] Both the Individual Defendants' and the Company's opening briefs address the Plaintiffs' failure to plead that any alleged misstatement was actionable based on its substantive content. To assist the Court in the required individualized analysis in that regard, the Individual Defendants attached to their Opening Brief a chart for each Individual Defendant detailing each of the alleged misstatements attributed to each of Mr. Syron, Mr. Piszel, and Ms. Cook, along with the legal defects attendant to each alleged misstatement. *See* I.D. Opening Br. Ex. A (Cook), B (Piszel) & C (Syron). The Opposition does not address the individualized charts or the arguments set forth in them whatsoever.

The Opposition's actual knowledge argument falsely conflates allegations suggesting that the Individual Defendants were aware of market risks with (non-existent) allegations suggesting that the Individual Defendants were somehow aware of facts contradicting their statements. And the Opposition avoids reliance on the Complaint's confidential witness allegations because the purported witnesses had no substantive contact with any Individual Defendant.

A. The Opposition Conflates Awareness of Discussions About Market Risks With Actual Knowledge of Contrary Facts

In an attempt to show actual knowledge of false statements, Plaintiffs rely on purported internal "warnings" about the credit risks inherent in certain segments of the mortgage market. See Opp'n at 48-49. The Opposition relies on a "risk report" allegedly prepared in August 2007. *See* Compl. ¶¶ 221-42. But in their Opening Brief, the Individual Defendants enumerated numerous dispositive defects in the allegations concerning this so-called "risk report," none of which are answered in the Opposition. *See* I.D. Opening Br. at 17-20. The Complaint does not establish that any of the Individual Defendants actually saw this purported report or was told of its contents. The Complaint also gives no sense of what the report *actually said*, much less that it contained contradictory facts, as opposed to opinion and analysis. *See* Compl. ¶¶ 221-42. Nor does the Complaint allege that any Individual Defendant ever attended a meeting at which the report was discussed, or even that the report somehow represented an "official" policy or conclusion of Freddie Mac. *See* Compl. ¶ 223. The closest Plaintiffs come to connecting the report to any Individual Defendant is a second-hand hearsay allegation that the Individual Defendants "possibly" had to "sign off" on the report. Compl. ¶ 223. Yet the Opposition addresses none of these defects.

The Opposition also relies upon the Complaint's allegation that "in mid-2004, David A. Andrukonis ('Andrukonis'), Freddie Mac's Chief Risk Officer until 2005, told Syron the

Company was buying bad loans that 'would likely pose an enormous financial and reputational risk to the company and the country.'" Compl. ¶ 10; *see* Opp'n at 48.[3] Andrukonis's statement is a business recommendation, couched in a warning about inherent (and disclosed) market risks. The Opposition treats it as some sort of magic bullet. But Plaintiffs have no answer to the Company's and the Individual Defendants' explanations of why opinions and "warnings" rendered three years before the Class Period do not establish that Mr. Syron or any other Individual Defendant knew his or her statements to be false. *See* I.D. Opening Br. at 17-20; Freddie Mac Opening Br. at 24-25.

The fact that Freddie Mac personnel discussed market risks, and may even have "warned" (in some report or elsewhere) of various risks inherent in subprime investments, simply establishes the obvious: that there were competing viewpoints within the Company about those market risks. But the Opposition does not "specifically identify" *facts* that are contrary to the Individual Defendants' statements.[4] *Novak v. Kasaks*, 216 F.3d 300, 309 (2d Cir. 2000). Plaintiffs further argue that their risk report allegations demonstrate scienter because "Freddie failed to implement the plans set forth in the report." Opp'n at 49. This contention exposes the Plaintiffs' argument for what it actually is: a dispute (by hindsight) with the business decision to invest in subprime mortgages, not (as Plaintiffs would have it) the revelation of facts contrary to the Individual Defendants' statements.

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[3] References of this sort to Mr. Andrukonis are strewn throughout the Complaint. *See* Compl. ¶¶ 83, 86, 87, 90, 101, 303, 304 & 538.

[4] Describing the creation of the alleged risk report, Plaintiffs state, "in the midst of the economic crisis, Freddie's risk management personnel undertook concrete steps to understand the risks associated with the subprime crash … and create various strategies to minimize the risks related to defaulting non-prime non-traditional loans." Opp'n at 49. This description is unremarkable. Analyzing the risks and opportunities in a changing market is standard (and responsible) corporate practice.

Plaintiffs also argue that the Individual Defendants "knew" that the Company's purchase of private-label mortgage-backed securities "collateralized by subprime mortgage loans created a significant, material exposure to risk." Compl. ¶ 90. This allegation lacks any specific factual content that is tied to, much less contrary to, the information conveyed in any alleged misstatement made by an Individual Defendant. It also describes a warning of a business risk, not a contrary fact.[5]

B. No Other Allegations Establish That Any Individual Defendant Was Aware of Facts That Rendered Any Statement False When Made

The Opposition makes no effort to explain how the "confidential witness" allegations in the Complaint establish each of the Individual Defendants' knowledge of facts that contradicted specific statements each made. Nor could the Plaintiffs meet this requirement. Few, if any, of the confidential witnesses purport to have had any direct contact with the Individual Defendants.

Rather than allege direct contact with the Individual Defendants—and thus a basis for what each Individual Defendant purportedly "knew"—the confidential witness allegations are crafted to give the (mis)impression of direct contact. For example, the Complaint cites to a former employee allegedly "assigned to Piszel's management reporting group during Piszel's time as Freddie Mac's CFO," who purportedly has information concerning Freddie Mac's ability to handle "lower quality" loans. Compl. ¶ 42. But there is no allegation that this person had either any direct contact with Mr. Piszel or some other way to come by personal knowledge of what Mr. Piszel supposedly knew. Similarly, Plaintiffs allege that certain information "should have made [its] way to … a Vice President … and on to Syron, as [she] reported to Syron." Compl. ¶ 249. Such vague and generalized allegations in the Complaint to the effect that certain facts "*would have* created an awareness in Freddie Mac's top management," or that management

[5] That risk was also fully disclosed. *See* Freddie Mac Opening Br. at 45-48.

"*had to know* the exposure to risk was a 'bomb that was ready to go off,'" Compl ¶ 186 (emphasis added), do not establish actual knowledge on the part of any Individual Defendant. *See* I.D. Opening Br. at 16-17.

This lack of a compelling nexus between any confidential witness and any of the Individual Defendants pervades the Complaint. *See, e.g.*, Compl. ¶¶ 41, 42, 46, 103, 108, 180, 186, 224, 236, 249, 271, 287 & 485. It is fatal to the Plaintiffs' claims against each of the Individual Defendants. *Novak*, 216 F.3d at 314 (confidential source allegations must "support the probability that a person in the position occupied by the source would possess the information alleged").

CONCLUSION

For the reasons stated herein, in the Individual Defendants' Opening Brief, and in Freddie Mac's Opening and Reply Briefs, the claims of primary and secondary liability asserted against each Individual Defendant should be dismissed with prejudice.

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Respectfully submitted,

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